Nos. 83-1321, 83-1432, 83-1433,
83-1442, 83-1443, 83-1618

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

THE PEOPLE OF THE STATE OF CALIFORNIA, *et al.*,
Petitioners,

v.

TENNECO OIL COMPANY, *et al.*,
Respondents.

On Petitions For A Writ Of Certiorari To The United States Court of Appeals For The Fifth Circuit

BRIEF OF UNION OIL COMPANY OF CALIFORNIA, THE BEAMON PARTIES AND THE LUCERNE GROUP IN OPPOSITION

Of Counsel:
DEE H. RICHARDSON
UNION OIL COMPANY OF CALIFORNIA
300 North Carrizo Street
Midland, Texas 79701

MICHAEL J. HENKE
(*Counsel of Record*)
JAMES R. LAYTON
VINSON & ELKINS
1101 Connecticut Ave., N.W.
Washington, D.C. 20036
Counsel for Respondent Union

[Additional Counsel
listed on inside of cover]

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PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

QUESTION PRESENTED

Whether transfers of interests in essentially undeveloped natural gas leases to an interstate pipeline for exploration, development, and eventual production of gas for sale to the pipeline's customers, can constitute sales of gas within the jurisdiction of the Federal Energy Regulatory Commission, under Section 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b) (1982).

LIST OF PARTIES

The respondents adopt the list of parties in the Petition filed by the People of the State of California and the Public Utilities Commission of the State of California in No. 83-1321, at ii-vii. The respondent parties joining this brief are:

Union Oil Company of California ("Union")

Robert Beamon
Robert Beamon, Trustee
Pattie Ann Beamon Lundell
Thomas L. Hail, Trustee
(The "Beamon Parties")

W. Watson LaForce, Jr.
Henry P. Ishma, Jr. Estate
Robert T. Isham
Josephine C. Jacobson
J. Roberts Jones
Nancy LaForce Keyes
Frederic P. G. Lattner, Trustee,
U/T Martha M. Lattner, Settlor
Suzanne LaForce Baber
James C. Bard
Douglas N. Bard
Ralph A. Bard, Jr.
Roy E. Bard, Jr.
G. Brainard, Jr. Trust
Continental Illinois National Bank and
Trust Company, Trustee Trust #23935
Continental Illinois National Bank and
Trust Company, Trustee Trust #23949
Eleanor Isham Dunne
Charles W. Farnham, Jr.
Robert B. Farnham
Walter B. Farnham

Elizabeth B. Farrington
Minnie A. Fitting
R. U. Fitting, Jr. Estate
Robert D. Fitting
Nancy H. Gerson
John R. Grimes
Ruth N. Halls
Cortland T. Hill
Elsie F. Hill
Louis W. Hill, Jr.
Albert L. Hopkins, Jr.
George S. Isham
R.S. MacDonald, A. MacDonald and
  Northern Trust Co., Trustees
  U/W of N.S. MacDonald, Deceased
Mary F. Love
William J. McDermott, Trustee
Nora R. Ranney
Catherine H. Ruml
Edward L. Ryerson, Jr.
Sabine Royalty Corporation
Shaw, Isham & Company
John I. Shaw, et al., Trustee
James Simpson, Jr. Trust
William E. Simpson Trust
Sydney Stein, Jr.
Northern Trust Co., Trustee, U/W of John Stuart
Robert Douglas Stuart Estate
William P. Sutter
Michael Simpson Trust
Patricia Simpson Trust
Katharine I. White
Kay B. Gundlach
Frederick F. Webster Trust
Mary S. Zick

David Waller Dangler
(The "Lucerne Group")

SUBSIDIARIES (EXCEPT WHOLLY OWNED SUBSIDIARIES) AND AFFILIATES OF RESPONDENT UNION OIL COMPANY OF CALIFORNIA:

Kaneb Services, Inc.

Magma Power Co.

Unocal

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BRIEF OF UNION OIL COMPANY OF CALIFORNIA, THE BEAMON PARTIES AND THE LUCERNE GROUP IN OPPOSITION

Respondents Union Oil Company of California ("Union"), the Beamon Parties (Robert Beamon, Individually and as Trustee; Tom L. Hail, Trustee; and Pattie Ann Beamon Lundell), and the Lucerne Group (W. Watson LaForce, Jr. *et al.*) respectfully request that this Court deny the petitions for writ of certiorari, seeking review of the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

STATEMENT OF THE CASE

The petitions in this case[1] arise out of a series of lease sales that occurred during the early 1950's in the San Juan Basin area of northwestern New Mexico. The earliest of these were between El Paso Natural Gas Company ("El Paso") and certain predecessors of the various respondents; these were called Gas Lease Agreements or GLA's. Later but essentially similar transactions involved Pacific Northwest Pipeline Company and other respondents or their predecessors; these were called Pacific Lease Agreements or PLA's.[2]

Geology of the San Juan Basin

The numerous leases that were the subject of the 35 GLA's involved in this proceeding covered hundreds of thousands of acres in a general area of New Mexico referred to as the San Juan Basin. Consulting geologists retained by El Paso expressed great confidence that "large volumes of natural gas were available for extrac-

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[1] Petitions for Writ of Certiorari have been filed by the People of the State of California, *et al.* ("California") (No. 83-1321); the Public Utility Commissioner of Oregon, *et al.* ("Oregon") (No. 83-1432); Northwest Pipeline Corporation, *et al.* ("Northwest") (No. 83-1433); El Paso Natural Gas Company ("El Paso") (No. 83-1442); Pacific Gas and Electric Company, *et al.* ("PG&E") (No. 83-1443); and the Federal Energy Regulatory Commission ("FERC") (No. 83-1618). Citations to the various petitions will be in the form "California Pet. at ____." The appendix prepared by California will be cited as "Pet. App. at ____."

[2] Union is a party to GLA's 76, 348, and 349. The Beamon Parties have interests under GLA's 77, 350, and 351. The Union GLA's apply to five-sixths, and the Beamon GLA's, one-sixth, of the working interest in substantially the same leases. The Lucerne Group is a party to GLA 66. This brief in opposition specifically addresses only the GLA transactions.

tion." Pet. App. at 53a. But it was obvious in the early 50's that the gas-bearing formations in the basin are "of varying depths and thicknesses," *id.* at 52a, and are "characterized by relatively low porosity and permeability," *id.* at 52a; *see also id.* at 9a, 127a. Since "[r]ecovery of natural gas from each productive formation is a function of the variations in the permeability and in the porosity of the formation," *id.* at 127a, and since the "Basin's geologic structure does not reveal those variations in any productive formation," *id.* at 127a-128a, the district court found that "geologic structure has little or no direct influence upon the localization of recoverable gas reserves," *id.* at 128a. For this reason the district court found, *id.*, and the court of appeals specifically affirmed, *id.* at 9a, that "*actual drilling is the only method of definitely locating recoverable gas saturations*" in the basin. (Emphasis added.)

Moreover, "[b]ecause the productive formations are tight, even where drilling located recoverable reserves, completed wells delivered gas in low volumes." *Id.* at 128a. In fact, the district court found that at the time the GLA's were executed, "[w]ells in the Basin generally were incapable of recovering commercially significant amounts of gas. . . . [T]hese wells [were] generally of such low deliverability that a producer could not hope to recoup his drilling costs. . . ." *Id.* at 132a. In short, only a regulated pipeline—which could include capital costs in its rate base and other drilling and operating costs in its cost of service, thus assuring that the slower the gas production the greater the aggregate return—could afford to develop these properties. *Id.* at 128a, n.13.

It was for these reasons that respondents' predecessors sold, and El Paso[3]—"in effect trading on its status as a utility regulated on the 'cost of service' basis," *id.* at 133a—purchased, the leases in question.[4] What was transferred pursuant to the GLA's were the leases or working interests—that is, the right to explore for, develop, and produce the gas reserves that were thought to underly the leases.[5] In exchange for that right, respondents' predecessors retained an overriding royalty, applicable only to the net working interest assigned, expressed in terms of cents per thousand cubic feet of gas

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[3] At the time most of the GLA's were executed, El Paso was the only interstate pipeline serving the basin. A second interstate pipeline was later constructed to the basin, and for a time a second customer for natural gas was available. However, El Paso soon purchased that pipeline in violation of the antitrust laws. *See* United States v. El Paso Natural Gas Pipeline Co., 376 U.S. 651 (1964).

[4] The GLA's here at issue were preceded by the so-called "Barker Dome transaction" (GLA-32) which most petitioners disingenuously advance as evidence of an intent to evade Commission jurisdiction, even though it is not involved in this proceeding. *See, e.g.*, El Paso Pet. at 4-6; FERC Pet. at 4-5. Both the district court and the Commission have rejected that theory, finding that the "parties did not enter into the GLA's [here at issue] as a means of shifting payments as in *Rayne Field* [United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392 (1965)]." Pet. App. at 133a; *and see* William G. Webb, 49 F.P.C. 17, 26 (1973). The district court explained that "the history of the Barker Dome agreement is not analogous to the agreements here at issue." Pet. App. at 125a, n.5. *Inter alia*, the Barker Dome agreement provided for an up-front payment tied to an estimate of reserves, whereas these GLA's did not. *Id.* at 127a & n.11.

[5] The first GLA's transferred only gas rights. But contrary to the Commission's assertion, FERC Pet. at 7, oil rights were also transferred by later GLA's. For example, GLA 348 transferred to El Paso Products Co. rights to all of the oil underlying that acreage.

produced from the acreage,[6] subject to escalation and redetermination at specified intervals.

Early Procedural History

For the next twenty years, the GLA's were consistently treated as nonjurisdictional lease sales (rather than sales of natural gas for resale in interstate commerce) by all parties, including the Federal Power Commission.[7] Thus, passthrough of the overriding royalties as an element of the cost of service of El Paso's own pipeline production was consistently sought by El Paso and regularly approved by the Commission—neither ever suggesting that the royalties were in fact payments for sales of gas. In *William G. Webb*, 49 F.P.C. 17 (1973), the Commission directly addressed the argument, made by its staff, that it "should regulate the transfer of the gas reserves here involved from the producers to El Paso in

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[6] The petitioners attempt to distinguish the form of the royalties here from those paid in the usual lease transaction. *See* FERC Pet. at 7, n.9; El Paso Pet. at 7-8. Those arguments fail to recognize the obvious: all royalties (including those here at issue) may be stated as a percentage of total production revenues. The fact that the so-called "special overriding royalty" was paid to the respondents based on the percentage interest they sold to El Paso (rather than on the totality of production) can have no significance. Similarly insignificant is the level at which the royalty is set. That a "base" royalty is frequently one-eighth (12 1½%), and the "special overriding" royalties here constitute a higher percentage has no legal or evidentiary significance. Royalties of all types—regular, overriding, or special overriding—can be found at all levels, high and low. To allow the level of the royalty to determine the Commission's jurisdiction would exalt form over substance.

[7] Both the Federal Power Commission and its successor the Federal Energy Regulatory Commission are referred to herein as "the Commission."

accordance with the *Rayne Field* case." *Id.* at 25. Agreeing with El Paso's position in that case, the Commission held that "the transactions should *not* be considered equivalent to the *Rayne* transactions because they arose under different circumstances." *Id.* at 26. The Commission thus rejected the staff's appeal that it hold these lease sales jurisdictional.[8]

Only when arbitration pursuant to the terms of the agreements resulted in the fixing of the royalty under one GLA at a level unacceptable to El Paso did that petitioner for the first time assert—in the suit that led to these petitions—that the lease sales were jurisdictional sales of gas. Following a seven-week trial, the United States District Court for the Western District of Texas found that "little if any actual drilling had been done on any acreage when its respective GLA was executed," and that "each GLA" was, therefore, "an agreement to transfer acreage which was not substantially developed." Pet. App. at 132a. The court next found that the "GLAs in issue were not transfers of leases with proven reserves . . . [b]ecause insufficient drilling had been done to prove up reserves in the specific acreage transferred. . . ." *Id.* at 131a. Finally, the court found that the GLA's "were not the economic equivalents of gas sales contracts," since "these agreements arose from the unique economic situation of the parties and reflected their efforts to structure the transactions so that El Paso would explore for and develop gas reserves in the Basin." *Id.* at 133a. On this basis the court held that "each agreement at issue in this

[8] The owners of the interests adjudicated in *Webb* (respondents here) have consistently argued that the *Webb* holding of nonjurisdiction is *res judicata* as to them. Because of its decision on the principal issues, the court of appeals did not reach that question. Pet. App. at 19a.

litigation . . . is not a 'sale in interstate commerce of natural gas for resale' within the meaning of Section 5 of the Natural Gas Act of 1938.' " *Id.* at 134a-135a.

This conclusion was particularly appropriate in the context of the Union, Beamon and Lucerne GLA's. On the 26,687.41 acres covered by GLA 76, for example, only four wells had been drilled at the time the agreement was signed. On GLA 348, transferring deeper rights to the same acreage, only two wells were in existence at execution. Pet. App. at 66a-67a. GLA's 77 and 350 applied to one-sixth of the working interest in leases on substantially the same lands. *Id.* Lucerne's GLA 66 had no wells on 2,480 acres at execution. *Id.* The GLA's thus allocated to El Paso the burdens and risks of exploring, developing and producing the acreage, retaining for the predecessors of Union, the Beamon Parties, and Lucerne only the right to receive an overriding royalty on El Paso's production.[9]

Court Of Appeals Decision

El Paso appealed the district court decision to the Fifth Circuit. While that appeal was pending, the Commission instituted a proceeding to reconsider the jurisdictionality

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[9] Contrary to El Paso's assertion, Union did not "voluntarily accept . . . reassignment" of its GLA leases. *See* El Paso Pet. at 10, n.12. Union agreed to accept reassignment of GLA's 76, 348, and 349, effective October 1, 1983, only in settlement of a state court lawsuit brought by El Paso. *See* El Paso Natural Gas Co. v. Tenneco Oil Co., *et al.*, No. 83-50539 (Dist.Ct. of Harris County, 11th Judicial Dist. of Texas, Feb. 27, 1984). The settlement leaves the jurisdictional question unresolved for periods prior to October 1, 1983. The Beamon Parties and the Lucerne Group have rejected El Paso's purported reassignments, and the state court litigation confirmed their right to do so.

of the GLA's. Relying on the stipulated district court record—supplemented by some new evidence principally concerning agreements not litigated in the district court—the Commission on September 25, 1980 reversed its three-decade-old position and held that the GLA's are subject to its jurisdiction. Pet. App. at 21a. Petitions for review of the Commission decision were consolidated with the pending appeal from the district court holding, and the court of appeals addressed both together.

The court of appeals held that the GLA's are not sales of gas as defined by the Natural Gas Act, 15 U.S.C. §§ 717-717z (1982) ("NGA"). Pet. App. at 5a. It looked to the three-pronged test of *Continental Oil Co.* v. *Federal Power Commission*, 370 F.2d 57 (5th Cir. 1966), *cert. denied* 388 U.S. 910 (1967) ("*Ship Shoal*"), derived from this Court's opinion in *Rayne Field.*[10] Noting that a lease sale transaction is not jurisdictonal "[u]nless all the *Rayne Field* factors . . . are satisfied," Pet. App. at 14a-15a, the court focused on one prong of the *Ship Shoal/ Rayne Field* test: substantial development. A unanimous panel specifically held that the "reserves underlying the leaseholds were not substantially developed at the time the lease sales were executed because of the lack of 'imminent ability to produce in commercial quantities.' " *Id.* at 15a (quoting *Ship Shoal*, 370 F.2d at 64). Explaining this holding, the court acknowledged that "[a]n important factor" was "the limited extent to which the Basin had

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[10] The test is comprised of three questions:

"(1) Is the economic effect of the transfer similar to that of a conventional sale?

"(2) Is the subject of the transaction 'proven and substantially developed' reserves?

"(3) Is the transfer of the reserves for purpose of interstate transmission and resale?" 370 F.2d at 62.

been drilled at the time the GLAs and PLAs were executed." *Id.* at 15a. It noted that "the few wells in the ground when the agreements were executed could not have come close to depleting the acreage," *id.* at 16a, and pointed out that both the Commission and the courts have considered the number of wells existing at execution (in comparison to the number needed to complete production) a relevant factor, *id.* at 16a-17a (citing *Texas Gas Transmission Corp.*, 3 FERC (CCH) ¶ 61,135 (1978), and *Rayne Field*, 381 U.S. at 396 and n.3, 403 and n.8).

Because of its holding that the GLA's were not substantially developed, the court of appeals had no occasion to address the district court's finding that the GLA's did not transfer proven reserves[11] and were not the economic equivalents of gas sales. Thus, the only questions before this Court are whether substantial development should continue to be a requirement of the *Rayne Field* test, and if so, whether the court of appeals erred in holding that the GLA's were not substantially developed. If the judgment below is reversed, however, the court of appeals will still have to consider the correctness of the district court's holdings that the GLA's did not transfer proven reserves and were not the economic equivalent of sales of gas. It will also have to decide other difficult questions, such as the *res judicata* and collateral estoppel issues flowing from the *Webb* case and the district court decision.

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[11] The court of appeals suggested in passing that "the reserves *in the Basin* may well have been 'proven' at least within reasonable estimates." Pet. App. at 15a (emphasis added). However, the Court did not purport to analyze that issue and certainly did not pass on the district court's finding that the existing reserve estimates covered the Basin as a whole and could not be related to *specific leases* without substantial further drilling. *See Id.* at 131a.

REASONS FOR DENYING THE WRIT

I. Review Of The Judgment Below Is Not Required To Protect The Public Interest

A. The Court of Appeals judgment has no prospective effect on gas consumers

A decision to reverse the decision below would have no prospective impact on natural gas consumers. A jurisdictional holding would require that the GLA gas be priced at or below Natural Gas Policy Act, 15 U.S.C. §§ 3301-3432 (1982) ("NGPA"), ceilings. But, as the Commission concedes in its petition, from the effective date of the NGPA (December 1, 1978), "[i]f the lease transactions are deemed to be non-jurisdictional . . . the pipelines [can] charge their customers only the applicable NGPA rate rather than the cost-of-service rate." FERC Pet. at 21. In other words, El Paso and other pipelines are now required to price their post-NGPA production at or below the applicable NGPA rate, regardless of the amount they pay in special overriding royalties or other production costs. This requirement stems from the decision of this Court in *Public Service Commission of New York* v. *Mid-Louisiana Gas Co.*, 463 U.S. ___, 103 S.Ct. 3024, 77 L.Ed.2d 668 (1983) ("*Mid-La*"). Accordingly, whether it is reversed or not, the judgment below will not affect what consumers pay for gas from and after the effective date of the NGPA.

To be sure, the Commission is empowered to increase the price that can be charged by El Paso so as to cover the costs resulting from its payment of the special overriding royalties. *See* NGPA § 104(b)(2), 15 U.S.C. 3314(b)(2) (1982); *Federal Energy Regulatory Commission* v. *Pennzoil Producing Co.*, 439 U.S. 508 (1979). But the responsibility of the Commission is to watch out for the

overall benefit of consumers.[12] The Commission could not, therefore, restrict its analysis of a request for higher rate to the particular leases at issue here. Rather, it would be required to take a comprehensive look at the impact of all current developments in gas pricing before granting such extraordinary relief to El Paso. Thus, it is significant that El Paso will receive a considerable windfall (as much as $20 million in 1983, $30 million in 1984, and more thereafter)[13] from the application of the *Mid-La* decision to pipeline production not here at issue. Payment of the special overriding royalties out of El Paso's own pocket would, at most, reduce slightly the extent of that windfall. In any event, no price in excess of the NGPA ceiling may be charged without prior Commission approval based on its independent assessment of what constitutes a just and reasonable rate.

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[12] The Natural Gas Act does not require the Commission to make price adjustments merely to prevent a producer (such as El Paso) from losing a portion of its profits due to royalty increases. *See* Federal Energy Regulatory Comm'n v. Pennzoil Producing Co., 439 U.S. 508, 517 (1979); *accord*, Cities Service Gas Co. v. Federal Power Comm'n, 424 F.2d 411 (10th Cir. 1969).

[13] These amounts are estimates transmitted orally to the Commission by El Paso. Letter from Charles A. McManus (Director, FERC Office of Congressional, Intergovernmental and Public Affairs) to Rep. Phillip R. Sharp (Chairman, Subcommittee on Fossil and Synthetic Fuels, U.S. House of Rep.) (Aug. 8, 1983). An exhibit in evidence in El Paso Natural Gas Co. v. Tenneco Oil Co., et al., No. 83-50539 (Dist. Ct. of Harris County, 11th Judicial Dist. of Texas, Feb. 27, 1984) contains an in-house El Paso estimate that revenues over the next twenty years will, because of *Mid-La*, be $4.6 billion more than they would otherwise have been.

B. Reversal of the Court of Appeals judgment is unlikely to benefit consumers retroactively.

Most petitioners emphasize the enormous refunds that would allegedly flow to consumers from a reversal of the court of appeals judgment. *See, e.g.*, FERC Pet. at 20-21; El Paso Pet. at 9, n.8; PG&E Pet. at 13-14. That argument is little more than a pipe dream.

First, as noted above a reversal of the instant court of appeals judgment would only require that court to review the other grounds for the district court's holding (inability to particularize proved reserves for individual leases and lack of economic equivalency). Even if the district court findings were overturned on those issues, the court of appeals would still be required to resolve thorny problems of *res judicata* and collateral estoppel, as even El Paso admits. *See* El Paso Pet. at 25; Pet. App. at 19a. Only if all of these issues were resolved in favor of El Paso would there be any predicate for the refunds sought by the pipeline.

Second, the Commission proceeding to determine whether refunds should be ordered, and if so in what amounts, had not yet even reached the hearing stage when it was suspended as a result of the court of appeals decision. However, Union and other respondents had submitted testimony in that proceeding suggesting that they had in fact been *underpaid* rather than overpaid by El Paso for the GLA gas during past periods. In short, El Paso's refund claim is at this point nothing more than a litigation position which remains to be tested.

Third and most important, even if there have been overcharges resulting from the parties' treatment of the GLA's as nonjurisdictional, the Commission's authority under the NGA to order refunds is far from unfettered; such extraordinary relief can only be granted where the

equities warrant it. *See, e.g., Laclede Gas Co.* v. *FERC*, 670 F.2d 38, 42 (5th Cir. 1982). The Commission has recognized that the absence of notice that a sale was jurisdictional is of particular concern in the weighing of factors for and against refunds. *See, e.g., Delta Gas, Inc.*, 43 F.P.C. 620, 623 (1970); *Hugoton Production Co.*, 41 F.P.C. 490, 497 (1969). An administrative agency may abuse its discretion by changing its position on a jurisdictional issue, and then imposing retroactive liability for failure to foresee that change. Like other administrative agencies, the Commission "may not render jurisdictional decisions, overrule them *retroactively* and thereby transform [a producer's] interim behavior, legal when pursued, into illegal [acts]." *Transportation Enterprises, Inc.* v. *National Labor Relations Board*, 630 F.2d 421, 424 (5th Cir. 1980) (emphasis in original).[14]

In short, the Commission's September 25, 1980 decision to assert jurisdiction over the GLA's was a radical departure from a three-decade-old position. Given its

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[14] The situation addressed by the Fifth Circuit in *Transportation Enterprises* was remarkably similar to that which would face any court hearing a request for retroactive application of the jurisdictional ruling pronounced by the Commission in this case. The N.L.R.B. had, through its regional office, ruled that a particular enterprise was outside its jurisdiction—just as here the Commission ruled in *William G. Webb* that some of the GLA's were outside of its jurisdiction. Years later, pursuant to an appeal from a subsequent ruling, the Board reversed its earlier jurisdictional ruling—just as here the commission has reversed *Webb* some years later in response to a subsequent petition by El Paso. The court in *Transportation Enterprises* ruled that the company was subject to the Board's jurisdiction from the date of the new jurisdictional decision. But prior to that decision, the company "had the right to rely on the decision . . . that it was not subject to the jurisdiction of the NLRB." 630 F.2d at 424. The respondents here had a similar right to rely on the Commission's decisions in *Webb* and in various El Paso rate cases, as well as on the district court's 1977 non-jurisdictional holding.

history of treating these transactions as non-jurisdictional, it would be simply impermissible for the Commission to impose refund liability retroactively for the period during which the parties—including all of the petitioners—treated the transactions as non-jurisdictional, even if El Paso ultimately prevails on the jurisdictional issue *and* proves overcharges.

C. The private dispute between El Paso and the respondents does not merit Supreme Court review.

Given the *sui generis* nature of the GLA transactions, the lack of impact that the court of appeals judgment can have on future gas prices, the retention by the Commission of authority fully to protect consumer interests, and the unlikelihood of refunds relating to past periods, the only remaining dimension of this case is the private contractual dispute between El Paso and the respondents. That dispute has already been the subject of a decade of negotiations, arbitration, and litigation; there is no need further to prolong its final resolution. To the extent that El Paso is unable to recover all of its costs of producing natural gas from the GLA leases, it merely suffers the consequences of its own decision to enter into the GLA's.

Moreover, the discussion of the impact of the judgment below on El Paso must occur in the context of the post-*Mid-La* world. El Paso stands to gain $4.6 billion from its newly-acquired ability to charge NGPA rather than cost-of-service rates to its customers.[15] To the extent that El Paso's operation of the GLA properties is in fact unprofitable,[16] its windfall is merely reduced somewhat.

[15] *See* n. 13, *supra*, and accompanying text.

[16] El Paso has been unable to establish this proposition in litigation brought in Texas state court. El Paso Natural Gas Co. v. Tenneco Oil Co., *et al.*, No. 83-50539 (Dist.Ct. of Harris County, 11th Judicial Dist. of Texas, Feb. 27, 1984). At the very least, the decision of the

The possible reduction of the amount of that windfall due to a private contractual relationship between El Paso and the respondents provides no basis for this Court to hear the instant case.

II. The Decision Of The Court Of Appeals Is Correct On The Merits.

A. The decisions of this Court properly require substantial development as a prerequisite for Commission jurisdiction over lease sales.

The petitioners point out, quite correctly, that the Commission has jurisdiction "over the rates of all wholesales of natural gas in interstate commerce." *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, 682 (1954). But that statement, oft paraphrased in the petitions, is beside the point; the question before the Fifth Circuit (and the question for which the writ is requested) was whether these sales of leases in fact constituted wholesales of natural gas. As the Commission put it, "the dispositive question is whether what was sold was gas or merely the right to explore for gas." FERC Pet. at 19.

Addressing that question, this Court established in *Federal Power Commission* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949) *("Panhandle")*, that sales of undeveloped natural gas leases are not covered by the NGA. However much petitioners dislike that decision, it has not been overturned. Even in *Rayne Field* this Court continued to recognize that sales of "the particular kind of leases that were before the court" in *Panhandle*, are outside the jurisdiction of the Commission. 381 U.S. at

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Texas court makes clear that mere assertions that El Paso will lose money on its production from the GLA properties cannot be accepted at face value.

404. The Court reached a different result in evaluating the *Rayne Field* lease sales only because it noted

> "[t]wo distinctions. . . . *First*, the *Panhandle* leases were undeveloped. The Rayne Field leaseholds were substantially developed. . . . *Second*, *Panhandle* did not involve a sale of natural gas for resale in interstate commerce, but a transfer by an interstate transmission company to a production company for sale of the gas in *intra*state commerce." 381 U.S. at 403-04 (footnote omitted) (emphasis in original).

There can be no question that the substantiality of development is a separate and appropriate criterion for determining jurisdictionality. The fact that this Court in *Rayne Field* distinguished *Panhandle* "first" on the basis that the "*Panhandle* leases were undeveloped," *id.* at 403, makes clear that the Court viewed substantial development as an issue separate and apart from whether the acreage was proven. Any doubt on this score was resolved by the Court's explanation:

> "The substantially of development is a relevant consideration, for the more that must be done before the gas begins its interstate journey, the less the transaction resembles the conventional wellhead sale of natural gas in interstate commerce which, as *Phillips* held, the Act has affirmatively placed within Commission jurisdiction." *Id.*

The court of appeals "perceive[d]" that this Court's concern with substantial development reflects its "concern with the apparent congressional intent not to regulate production." Pet. App. at 15a. This Court has held that the "production or gathering" exemption *see* NGA § 1(b), 15 U.S.C. § 717(b) (1982) "relates to the physical activities, processes and facilities of production or gathering, but not to sales of the kind affirmatively subjected to Commission jurisdiction." *Rayne Field*, 381 U.S. at 402.

The very essence of the "physical activities, processes and facilities of production" is the drilling of wells, the placement of casing, the erection of platforms, and the like.

The close identification of the drilling function with production or gathering is the key to understanding the relationship identified in *Rayne Field* between substantial development and economic equivalency. The *sine qua non* of a gas sale is that the seller has borne the risks[17] and expenses of drilling the well from which gas is produced. If those risks and expenses are transferred to the buyer—as they are in a sale of undeveloped leases—then the lease sale simply cannot be economically equivalent to the sale of gas.[18] For that reason, the court of appeals implicitly concluded that the lack of substantial development, and the consequent placement of the risks and burdens of drilling on the pipeline purchaser of the leases, made the GLA's quite different from jurisdictional sales

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[17] The risks here were substantial. Both the district court and the court of appeals specifically found that "actual drilling is the only method of definitely locating recoverable gas saturations" on the GLA's. Pet. App. at 9a; *see id.* at 128a.

[18] Both El Paso and the Commission noted that, even under a traditional gas sales contract, the producer ordinarily does not fully develop the property until he has obtained sales commitments for the gas. El Paso Pet. at 6, n.3; FERC Pet. at 17, n.15. That answer misses the point. Even if he waits until he has a sales contract in hand, it is still the producer who bears the risk and expense of drilling under such a contract. However, if a lease owner transfers his undeveloped lease, then the risk and expense of drilling are on the purchaser, and the transaction is not economically equivalent to a gas sale. That is what the district court meant when it found that "[t]he structuring of the economic risks and benefits between the parties more closely resembles the reallocation of risks and benefits in a farm-out than in a gas sales contract." Pet. App. 133a.

of gas. That decision is squarely—and properly—required by the opinions of this Court.

B. Substantiality of development is appropriately measured by the number of wells drilled.

Petitioners assert, however, that even if substantial development is a proper test, the court of appeals erred in counting wells and comparing the number of wells drilled with available drilling spaces. *See, e.g.*, FERC Pet. at 18-19. Elsewhere, however, the Commission has espoused the very approach it condemns here.

In *Texas Gas Transmission Corp.*, 3 FERC (CCH) ¶ 61,135 (1978), for example, the Commission looked carefully at the development of the leases prior to finding that their sale was not a jurisdictional sale of gas. The Commission noted that considerable development had taken place prior to the sale; fourteen wells had been completed, ten were already producing, and additional wells had been started. The Commission observed, however, that plans were "under way to complete 50 wells that had been started and abandoned [by the seller] and to start an additional 50 new wells." *Id.* at p. 61,405. It therefore concluded that the sellers "had not sufficiently developed the field to be able to conduct economically feasible wellhead arrangements." Thus, the Commission in *Texas Gas Transmission* made a jurisdictional decision by looking at the extent of development, and comparing the drilling completed with that required for full development.

Even more illuminating is the Commission's practice in administering the incentive price provision in section 107(c)(5) of the NGPA, 15 U.S.C. § 3317(c)(5) 1983), as it relates to "tight formations." In that context the Commission has developed the practice of excluding areas that were "substantially developed" prior to the issuance of an

infill drilling order, provided certain other factors are also present. In determining which areas are substantially developed, the Commission counts wells—that is, it looks to the "total number of developed [drilling] units . . . divided by the total number of available [drilling] units." Order No. 220, FPC Docket RM79-76 (April 2, 1982), 47 Fed. Reg. 15316 (1982). Significantly, the Commission has held that 41% development "does not . . . [constitute] substantial development." *Id.* at 15317. None of the significant GLA's here at issue even approached 41% development as of the date of execution.[19]

C. The decision below is consistent with *Ship Shoal*.

All of the petitioners insist that the decision of the court below conflicts with *Ship Shoal*, an earlier decision by another panel of the same court. But a careful comparison of the two decisions belies that assertion.

As a matter of law, in deciding the case at bar the court below applied precisely the same three-pronged test it had formulated in *Ship Shoal*. Pet. App. at 12a. If the assertion is that the court below applied its own *Ship Shoal* test improperly, it is the responsibility of the Court of Appeals for the Fifth Circuit and not the responsibility of this Court to resolve that issue.[20] A conflict between

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[19] For example, based on 160 acre spacing, the four Pictured Cliffs wells completed on GLA's 76 and 77 as of the date of execution constituted approximately 2% development. *See* Pet. App. at 66a. The Mesa Verde formation underlying GLA 76 was *undrilled* at the date of execution. *Id.* By May 1, 1975, there were 167 wells in the Pictured Cliffs and 63 wells in the Mesa Verde formation. *See* Joint Appendix at 232a-233a, El Paso Natural Gas Co. v. Sun Oil Co., 708 F.2d 1011 (5th Cir. 1983).

[20] The appeals court's summary denial of petitioners' suggestions for rehearing *en banc*, without a single dissenting vote, suggests that the Fifth Circuit itself saw no conflict with *Ship Shoal*. Pet. App. at 152a.

panels of the same court does not generally present a question for which certiorari will be granted. *See Davis* v. *United States*, 417 U.S. 333, 340 (1974); *Wisniewski* v. *United States*, 353 U.S. 901 (1957) *(per curiam)*.[21]

In any event, however, the court of appeals had ample factual basis on which to distinguish this case from *Ship Shoal*. In *Ship Shoal*, twelve wells had been drilled on 3,000 acres, with multiple completions, prior to the sale.[22] That is the equivalent of one well for each *250 acres*. Here the situation was vastly different. Development prior to execution of the GLA's[23] had been extremely limited. The

[21] Mr. Justice Harlan has noted that "contrary decisions between different panels of the same Court of Appeals will not be considered to present a reviewable conflict, since such differences of view are deemed an intramural matter to be resolved by the Court of Appeals itself." Harlan, *Manning the Dikes*, 13 Rec. A.B. City N.Y. 541, 552 (1958).

[22] As the presiding examiner noted in his initial decision:

> "The CATC producers before May 10, 1961 had erected three drilling platforms at Ship Shoal and had drilled about 12 wells, with multiple completions, therefrom. Costs to the producers do not appear, but depreciable property of the producers at Ship Shoal seems to have been $2,280,000. . . . Substantial quantities of gas and oil were found. The gas was shut in, and has remained unconnected to date. Some of the oil was produced, and was barged to shore from storage tanks on the platforms." *Tennessee Gas Transmission Co.*, 30 F.P.C. 759, 799 (1963).

[23] The Commission assails the court's use of the date of execution as the time to measure development. FERC Pet. at 17, n.15. But petitioner fails even to acknowledge "the controlling authorities"—*Rayne Field* and *Ship Shoal*—on which the court based its conclusion that "jurisdiction must be evaluated at the time lease-sale agreements are executed." Id. at 17a. The reason for that conclusion is apparent: Upon execution, the parties are bound to their agreement; the actual transfer of title that occurs at closing is but a ministerial act required by the prior agreement. The jurisdictionality of the deal must be determined when the parties become bound to it.

court cited "dramatic example[s] of the lack of substantial development." Pet. App. at 16a. Union's GLA 348 is such an example; it had only two wells on over 26,000 acres—less than one for each 13,000 acres. Pet. App. at 66a-67a. Not only could the court fairly conclude that "the acreage was far less drilled than the land covered by the agreements found jurisdictional in *Rayne Field*," *id.* at 15a, it was also compelled to conclude that development had not reached the point that had been reached in the *Ship Shoal* case.

D. The *Louisiana Land, Mobil,* and *Cities Service* decisions demonstrate the propriety of the decision below.

Various of the petitions also suggest that the decision below conflicts with three other court of appeals decisions: *Louisiana Land and Exploration Co.* v. *Federal Energy Regulatory Commission*, 574 F.2d 204 (5th Cir. 1978), *cert. denied*, 439 U.S. 1127 (1979) *("Louisiana Land"); Mobil Oil Corp.* v. *Federal Power Commission*, 463 F.2d 256 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 976 (1972) *("Mobil");* and *Cities Service Gas Co.* v. *Federal Power Commission*, 424 F.2d 411 (10th Cir. 1969), *cert. dismissed*, 400 U.S. 801 (1979) *("Cities Service")*. On the contrary, these cases in fact support the conclusions of the court below.

The most recent of the three cases, *Louisiana Land*, was decided by a panel that included two of the judges who heard the appeal in the instant case.[24] The panel recognized, as the Commission had found, that the *Louisiana Land* "transaction was closely connected with [a] lease-sale transaction." *Delta Development Co.*, 56 F.P.C. 922, 925 (1976). *See* 574 F.2d at 206-07. But the

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[24] **Circuit Judges Brown and Roney were joined by Judge Godbold in *Louisiana Land*, and by Judge Tjoflat in this case.**

jurisdictional question addressed by both the Commission and the court of appeals in *Louisiana Land* had to do with an "agreement [that] arose from separate negotiations." 56 F.P.C. at 925. Evaluating that separate transaction, the court of appeals declined to apply its three-pronged *Ship Shoal* test because, as the court accurately noted, Louisiana Land and Exploration "did not sell a lease in a transaction that mirrors those in *Rayne Field* and *Ship Shoal*." 574 F.2d at 207. Instead the court distilled the essence of the *Ship Shoal* analysis: a determination of jurisdictionality must not "ignore . . . economic realities." *Id.* Application of that general principle led the panel to conclude that the *Louisiana Land* transactions were jurisdictional, while the clearly compatible *Ship Shoal* test itself later compelled an opposite conclusion in the case of the GLA lease sales.

Similarly consistent with the result and rationale below is the decision of the Court of Appeals for the D.C. Circuit in *Mobil*. The court there rejected an attempt by the Commission to extend its jurisdiction to cover royalty provisions of oil and gas leases. The *Mobil* court evaluated the " 'significant and determinative economic facts'," as required by *Rayne Field*. 463 F.2d at 262. It therefore recognized the basic economic difference between oil and gas leases, which transfer only the right to explore, develop, and market (if exploration and development are successful), and sales of oil and gas produced from such leases, *id.* at 262-63, much as the court below recognized the differences between sales of undeveloped leases and the sale of gas-in-place by transfer of proved and developed leases.[25]

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[25] Significantly, the *Mobil* court noted that exclusion of royalty arrangements from the Commission's jurisdiction would not prevent the Commission from achieving its purposes—*i.e.*, "to protect the

In *Cities Service*, the Tenth Circuit did not even address the question of jurisdiction. Rather, recognizing its lack of "jurisdiction over security transactions relating to natural gas companies," 424 F.2d at 417, the Commission proceeded to consider "the proper allowance in [Cities Service] Gas Co.'s cost of service for gas from production properties it previously owned," *Continental Oil Co.*, 39 F.P.C. 1034, 1047 (1968). The court of appeals held that the Commission's lack of jurisdiction over the transfer did "not foreclose the FPC from fixing appropriate rates under the Act," 424 F.2d at 417, and affirmed a Commission order requiring Cities to pay more for gas than it was authorized to charge, *id.* at 415. Thus, the Tenth Circuit upheld precisely what El Paso and the Commission complain about here.

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ultimate beneficiaries [of the NGA] against exploitation by natural gas companies." *Id.* at 263. "[T]he FPC's jurisdiction over rates chargeable by a producer includes authority to determine the reasonableness of costs incurred, even though these are not subject to direct FPC control. . . ." *Id.*

CONCLUSION

The petitions for writ of certiorari should be denied.

Respectfully submitted,

MICHAEL J. HENKE
(Counsel of Record)
JAMES R. LAYTON
VINSON & ELKINS
1101 Connecticut Ave., N.W.
Washington, D.C. 20036

Counsel for Respondent Union

Of Counsel:
DEE H. RICHARDSON
UNION OIL COMPANY OF CALIFORNIA
300 North Carrizo Street
Midland, Texas 79701

J. O. TERRELL COUCH
HUTCHESON & GRUNDY
3300 Citicorp Center
Houston, Texas 77002

Counsel for Respondents,
The Beamon Parties

W. B. BROWDER, JR.
STUBBEMAN, MCRAE, SEALY,
LAUGHLIN & BROWDER
Post Office Box 1540
Midland, Texas 79702

Counsel for Respondents,
W. Watson LaForce, Jr., et al.

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